# FIVE-YEAR FINANCIAL SUMMARY

| | 2002 | 2001 | 2000 | 1999 | 1998 |
|---|---|---|---|---|---|
| | (in thousands except per share and shareholders data) | | | | |
| **Financial Results** | | | | | |
| Operating revenues | $ 1,991,509 | $ 1,723,978 | $ 1,709,474 | $ 757,940 | $ 419,452 |
| Gross margins | 896,100 | 654,622 | 608,990 | 328,889 | 198,419 |
| Operating expenses | 1,525,734 | 751,492 | 604,680 | 285,358 | 154,184 |
| Income (loss) from continuing operations | (629,634) | (96,870) | 4,310 | 43,531 | 44,235 |
| Interest expense | (129,536) | (49,248) | (37,982) | (20,978) | (15,546) |
| Investment income and other | (5,382) | 8,023 | 8,981 | 9,800 | 5,700 |
| Income (loss) from continuing operations before income taxes and minority interests | (764,552) | (138,095) | (24,691) | 32,353 | 34,389 |
| Benefit (provision) for income taxes | 798 | 42,470 | 6,467 | (13,145) | (10,223) |
| Income (loss) from continuing operations before minority interests | (763,754) | (95,625) | (18,224) | 19,208 | 24,166 |
| Minority interests in net loss of consolidated subsidiaries | 14,914 | 141,448 | 67,820 | 24,788 | 5,315 |
| Discontinued operations, net of taxes and minority interests | (101,655) | (1,291) | (43) | 667 | 910 |
| Extraordinary item, net of taxes | (13,447) | — | — | — | — |
| Net income (loss) | $ (863,942) | $ 44,532 | $ 49,553 | $ 44,663 | $ 30,391 |
| **Common Stock Data** | | | | | |
| Basic earnings (loss) per share | $ (30.04) | $ 1.54 | $ 1.85 | $ 1.64 | $ 1.45 |
| Diluted earnings (loss) per share | $ (30.04) | $ 1.53 | $ 1.83 | $ 1.62 | $ 1.44 |
| Basic earnings (loss) per share from continuing operations | $ (26.17) | $ 1.59 | $ 1.85 | $ 1.61 | $ 1.40 |
| Diluted earnings (loss) per share from continuing operations | $ (26.17) | $ 1.58 | $ 1.83 | $ 1.59 | $ 1.39 |
| Average shares outstanding: | | | | | |
| Basic | 29,726 | 24,390 | 23,141 | 23,094 | 18,660 |
| Diluted | 29,726 | 24,455 | 23,338 | 23,372 | 18,816 |
| Dividends paid per common share | $ 1.27 | $ 1.210 | $ 1.130 | $ 1.050 | $ .985 |
| Annual dividend rate at year end | $ 1.27 | $ 1.27 | $ 1.19 | $ 1.11 | $ 1.03 |
| Book value per share at year end | $ (12.25) | $ 14.56 | $ 13.65 | $ 13.00 | $ 12.21 |
| Common stock price range: | | | | | |
| High | $ 23.640 | $ 26.750 | $ 23.937 | $ 27.125 | $ 27.375 |
| Low | $ 4.300 | $ 18.250 | $ 19.125 | $ 20.625 | $ 20.250 |
| Close (at year end) | $ 5.080 | $ 21.050 | $ 23.125 | $ 22.000 | $ 26.438 |
| Common shareholders at year end | 9,885 | 10,358 | 10,371 | 10,475 | 10,116 |
| **Financial Position (as of December 31)** | | | | | |
| Total assets | $ 2,672,925 | $ 2,641,685 | $ 2,898,070 | $ 1,956,761 | $ 1,728,474 |
| Working capital | 18,863 | (245,780) | 40,314 | 100,193 | 57,739 |
| Short-term debt | 57,878 | 356,445 | 49,207 | 37,554 | 16,554 |
| Long-term debt, excluding current portion | 1,704,016 | 411,349 | 583,708 | 340,978 | 259,373 |
| Total debt (including subsidiaries) | 1,761,894 | 767,794 | 632,915 | 378,532 | 275,927 |
| Common shareholders' equity (deficit) | (456,076) | 396,578 | 319,549 | 300,371 | 282,134 |
| Preferred stock not subject to mandatory redemption | — | 3,750 | 3,750 | 3,750 | 3,750 |
| Preferred stock subject to mandatory redemption | 370,250 | 187,500 | 87,500 | 87,500 | 87,500 |
| Ratio of earnings to fixed charges(1) | — | — | — | 2.17 | 2.84 |

(1) The fixed charges exceeded earnings, as defined by this ratio, by $764.6 million, $138.1 million and $24.7 million in 2002, 2001 and 2000, respectively.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with "Item 6. Selected Financial Data" and our consolidated financial statements and related notes contained elsewhere in this Annual Report on Form 10-K. For additional information related to our industry segments, see Note 23 of "Notes to Consolidated Financial Statements" of our consolidated financial statements, which are included in Item 8 herein. For information regarding our revenues, profits/losses and assets, see our consolidated financial statements included in Item 8 hereof.

OVERVIEW

We operate our business in five reporting segments:

- electric utility operations;
- natural gas utility operations;
- communications;
- HVAC, plumbing and related services; and
- all other, which primarily consists of our other miscellaneous service and non-energy related operations and activities that are not included in the other identified segments, together with the unallocated corporate costs and investments, and any eliminating amounts.

Our financial condition has been significantly and negatively affected by the poor performance of our non-energy businesses and our significant indebtedness. NorthWestern reported losses on common stock for the year ended December 31, 2002, of $892.9 million or $30.04 per diluted share, compared with earnings on common stock of $37.5 million or $1.53 per diluted share in 2001. Full-year 2002 results were negatively impacted by $878.5 million in charges as further described below.

In February 2003, we outlined the elements of a turnaround plan intended to strengthen our balance sheet and improve our financial performance. The primary elements of our turnaround plan are to focus on our core electric and natural gas utility business and a commitment to reduce our debt through the application of proceeds from the sale of non-core assets, including Expanets, Blue Dot, our Colstrip Transmission Line and the Montana First Megawatts generation project. Absent proceeds from the sale of non-core assets, significant improvements in the operating results of our non-energy businesses, restructuring of our debt or raising additional capital, we will not have the ability to materially reduce our debt and our ability to fund our operations and service our substantial indebtedness will be adversely affected.

Consolidated revenues for 2002 were $2.0 billion, a 15.5 percent increase from $1.7 billion in 2001. Sales growth in 2002 was driven primarily by an increase in revenues from our newly acquired Montana electric and natural gas operations of $590.5 million as well as increased sales of $48 million, at Blue Dot, our heating, ventilation and air conditioning business, primarily from acquisitions. Consolidated revenues were adversely impacted by decreased revenues from Expanets of $321.6 million, our communications services business, due to deteriorating telecommunications markets and problems with its EXPERT system.

Our electric and natural gas utility segments, combined, reported 2002 operating income of $145.0 million, compared with operating income of $45.9 million in 2001. Revenues for 2002 grew to $775.4 million, a substantial increase from revenues of $251.2 million in 2001. On February 15, 2002, we completed the acquisition of the electric and natural gas transmission and distribution business of The Montana Power Company for $478.0 million in cash and the assumption of $511.1 million in existing debt and mandatorily redeemable preferred securities of subsidiary trusts of The Montana Power Company, net of cash received. Results for 2002 include 11 months of Montana utility operations. In 2002, our Montana utility operations contributed $113.1 million in operating income,

with revenues of $562.6 million, excluding results from January 2002. South Dakota and Nebraska utility operations contributed $31.9 million in operating income in 2002, with revenues of $212.7 million.

For 2002, Expanets reported an operating loss of $391.9 million, compared with an operating loss of $102.6 million in 2001. Expanets' revenues for 2002 were $710.5 million, compared with $1.03 billion in 2001. The decline in revenue was the result of a downturn in the economy generally and the telecommunications equipment market specifically, a focus on higher margin revenues and challenges with Expanets' EXPERT system implementation that have contributed to erosion of Expanets' customer base. Results for 2002 were also adversely impacted by goodwill and long-lived asset impairments taken in the fourth quarter of 2002 of $288.7 million and a $65.8 million increase in reserves and write-offs for billing adjustments, accounts receivable and direct write-offs relating to complications with Expanets' EXPERT enterprise software system.

Blue Dot reported an operating loss in 2002 of $311.3 million, compared with an operating loss of $13.8 million in 2001. Blue Dot's results were impacted by goodwill and long-lived asset impairments in the fourth quarter of 2002 of $301.7 million and poor economic conditions. Revenues were $471.8 million in 2002, compared with revenues in 2001 of $423.8 million. The increase in revenues was primarily due to acquisitions made during 2001 and 2002.

In our All Other segment, we had an operating loss in 2002 of $71.4 million, compared with an operating loss of $26.4 million in 2001. Revenues for the All Other segment in 2002 were $33.9 million, an increase of $16.9 million from 2001. The increase was primarily due to $27.9 million from the newly acquired Montana non-utility operations, offset by reduced revenues from the South Dakota and Nebraska non-utility voice and data networks business, which was transferred to Expanets mid-year.

On August 20, 2002, NorthWestern purchased the lenders' interest in approximately $19.9 million of short-term debt, together with approximately $6.1 million in letters of credit, of CornerStone outstanding under CornerStone's credit facility, which NorthWestern had previously guaranteed. No further drawings may be made under this facility. In addition, NorthWestern is owed $13.5 million from CornerStone and NorthWestern also has $9.2 million in letters of credit outstanding on behalf of CornerStone. As of December 31, 2002, the net recorded value of our receivables from and letters of credit exposure related to CornerStone was an aggregate $21.1 million.

## SIGNIFICANT CHARGES FOR 2002

During 2002, we recorded the following charges aggregating approximately $878.5 million:

| | |
|---|---|
| • Impairment of Blue Dot goodwill and other long-lived assets | $ 301.7 million |
| • Impairment of Expanets goodwill and other long-lived assets | $ 288.7 million |
| • Discontinued operations of CornerStone Propane, net of tax benefits | $ 101.7 million |
| • Valuation allowance for deferred tax assets | $ 71.5 million |
| • Expanets billing adjustments and accounts receivable write-offs and reserves | $ 65.8 million |
| • Impairment of Montana First Megawatts project | $ 35.7 million |
| • Retirement of acquisition term loan, net of tax benefits | $ 13.4 million |

*Goodwill and Other Long-Lived Assets—Expanets and Blue Dot.* We established our annual review of goodwill as required by SFAS No. 142, as of October 1, 2002. Impairment charges under the requirements of SFAS No. 142 and SFAS No. 144 for our goodwill and other long-lived assets were $301.7 million for Blue Dot and $288.7 million for Expanets, including $69.6 million for the impairment of Expanets' EXPERT system. Various factors contributed to the significantly reduced valuations of

Expanets and Blue Dot, including lower than expected performance, revised growth rate assumptions and reduced holding period assumptions, which negatively impacted the fair value of Expanets and Blue Dot.

*Discontinued Operations of CornerStone.* As a result of the deconsolidation transaction on November 1, 2002, we no longer have any economic interest in Cornerstone, other than the debt interests described above. During 2002, we recorded charges totaling $101.7 million for the write down of the value of our investment and financial arrangements in CornerStone and our share of net operating losses.

*Deferred Tax Allowance.* As a result of the lower than expected performance and significant charges associated with our non-utility businesses, we evaluated the realization of our net deferred tax assets and determined that a valuation allowance was appropriate due to the uncertainty of realizing certain tax benefits in the future, which resulted in a charge of $71.5 million (excluding a tax valuation allowance totaling $78.0 million relating to the impairment of Blue Dot's and Expanets' goodwill and other long-lived assets and Expanets' billing adjustments, accounts receivable write-offs and reserves). The deferred tax assets consisted primarily of net operating loss carry forwards and temporary differences associated with our non-utility businesses.

*Expanets Adjustments and Write-Offs.* Expanets recorded a reduction in revenues of $28.0 million for pending billing adjustments and recorded accounts receivable and other write-offs and related reserves of $37.8 million primarily related to complications with its EXPERT system billing and related data migration issues.

*Montana First Megawatts.* As of and at December 31, 2002, we determined that absent regulatory approval of the Montana First Megawatts' power sales contract with NorthWestern Energy, the value of the project was equal to the estimated salvage value of project equipment. Accordingly, we recorded an impairment charge of $35.7 million against our investment of approximately $78.4 million in the project. Due to adverse changes to the independent power generation development market, absent receipt of necessary regulatory approvals of the power sales contract, there is no assurance that we will be able to sell this asset at a favorable price, if at all, and therefore, we may be required to take additional charges.

*Retirement of Acquisition Term Loan.* In March 2002, we retired a $720 million term loan that was used for interim financing for the acquisition of the transmission and distribution business of The Montana Power Company. The recognition of deferred costs related to the interim financing resulted in an extraordinary loss of $13.4 million net of taxes.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management's discussion and analysis of financial condition and results of operations is based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and other assumptions that are believed to be proper and reasonable under the circumstances. We continually evaluate the appropriateness of our estimates and assumptions, including those related to goodwill and intangible assets, impairment of long-lived assets, revenue recognition, allowance for doubtful accounts, and minority interest in consolidated subsidiaries, among others. Actual results could differ from those estimates.

We have identified the policies and related procedures below as critical to understanding our historical and future performance, as these polices affect the reported amounts of revenue and the more significant areas involving management's judgments and estimates.



### *Goodwill and Indefinite-Lived Intangible Assets*

We believe that the accounting estimate related to determining the fair value of goodwill, and thus any impairment, is a "critical accounting estimate" because: (i) it is highly susceptible to change from period to period since it requires company management to make cash flow assumptions about future revenues, operating costs and discount rates over an indefinite life;

and (ii) recognizing an impairment has had a significant impact on the assets reported on our balance sheet and our operating results. Management's assumptions about future sales margins and volumes require significant judgment because actual margins and volumes have fluctuated in the past and are expected to continue to do so. In estimating future margins, we use our internal budgets.

SFAS No. 142 was issued during 2001 and is effective for all fiscal years beginning after December 15, 2001. According to the guidance set forth in SFAS No. 142, we are required to evaluate our goodwill and indefinite-lived intangible assets for impairment at least annually and more frequently when indications of impairment exist. Accounting standards require that if the fair value of a reporting unit is less than its carrying value including goodwill, an impairment charge for goodwill must be recognized in the financial statements. To measure the amount of the impairment loss to recognize, we compare the implied fair value of the reporting unit's goodwill with its carrying value. Our reporting units are consistent with our reporting segments as indentified in Note 23 of "Notes to Consolidated Financial Statements" included in Item 8 herein.

We adopted SFAS No. 142 effective January 1, 2002 and retained a third party appraisal firm who performed an evaluation and determined that no impairment charge was necessary at the date of adoption, and selected October 1 as the date for our annual goodwill impairment test. The annual independent third party valuations for Expanets and Blue Dot were completed as of October 1, 2002 using a discounted cash flow approach based on forward-looking information regarding market share, revenues and costs for each reporting unit. We also prepared an internal valuation for our Montana utility operations as of October 1, 2002. Various factors contributed to the significantly reduced valuations of Expanets and Blue Dot, including lower than expected performance, revised growth rate assumptions and reduced holding period assumptions, which negatively impacted the fair value of Expanets and Blue Dot. As a result, we determined that a substantial impairment to our investment in these companies had occurred and we recorded an impairment charge to goodwill and indefinite-lived intangible assets of $483.4 million during the fourth quarter of 2002.

*Long-lived Assets*

We evaluate our property, plant and equipment and definite-lived intangible assets for impairment whenever indicators of impairment exist. SFAS No. 144 requires that if the sum of the undiscounted cash flows from a company's asset, without interest charges that will be recognized as expenses when incurred, is less than the carrying value of the asset, impairment must be recognized in the financial statements. If an asset is deemed to be impaired, the amount of the impairment loss recognized represents the excess of the asset's carrying value as compared to its estimated fair value, based on management's assumptions and projections.

We recorded impairment charges of $69.6 million to write down the carrying amount of Expanets' EXPERT system and $25.4 million to write down the carrying amount of certain Expanets definite-lived intangible assets to their estimated fair value. These assets were identified as being carried at values that may not be recoverable due to the significant EXPERT operating deficiencies; the non-utility investment restrictions placed on us by the Montana Public Service Commission, or the MPSC; and the unfavorable business climate within the telecommunications industry.

We recorded an impairment charge of $35.7 million to write down the carrying amount of our investment in a 260-megawatt natural gas-fired generation project located in Great Falls, Montana. Based on certain events occurring during the fourth quarter of 2002, we have determined as part of our



restructuring plan to divest of this project and the assets have been written down to expected realizable value.

We recorded an impairment charge of $12.0 million to write off the carrying amount of Blue Dot property, plant and equipment and definite-lived intangible assets. These assets were identified as being carried at values that may not be recoverable, due to current and projected financial performance and to the non-utility investment restrictions placed on us by the MPSC.

*Revenue Recognition*

Revenues are recognized differently depending on the type of revenue. For NorthWestern Energy's South Dakota and Nebraska operations, as prescribed by the respective regulatory authorities, electric and natural gas utility revenues are based

on billings rendered to customers. Customers are billed on a monthly cycle basis. For NorthWestern Energy's Montana operations, as prescribed by the MPSC, operating revenues are recorded monthly on the basis of consumption or services rendered. To match revenues with associated expenses, we accrue unbilled revenues for electric and natural gas services delivered to the customers but not yet billed at month-end.

Communications and HVAC revenues are recognized when goods are delivered to customers or services are performed, except for revenues for services performed under certain material installation or service contracts, which are recognized in any given period based on the percentage of costs incurred to date in relation to total estimated costs to complete the contracts. Revenues at Expanets for certain other material and installation contracts are recognized on the completed contract method of accounting due to the inability to adequately estimate gross margins for these contracts. Certain judgments affect the application of our revenue recognition policy, primarily percentage of project completion. Revenue estimates in these areas are difficult to predict, and any shortfall in revenue or delay in recognizing revenue could cause our operating results to vary significantly from quarter to quarter and could materially impact future operating results. We continue to experience serious difficulties with the EXPERT system billing function. We provide a monthly reserve for billing adjustments at a rate in excess of industry standards, which we believe to be appropriate in our circumstances.

*Allowances for Doubtful Accounts*

We maintain a general allowance for doubtful accounts based on our historical experience, along with additional customer-specific allowances. We regularly monitor credit risk exposures in our accounts receivable. In estimating the necessary level of our allowance for uncollectible accounts, management considers the aging of its accounts receivable, the creditworthiness of our customers, economic conditions within the customer's industry, and general economic conditions, among other factors. When these factors change, the estimates made by management also change, which in turn impacts the level of our allowance for uncollectible accounts. The lack of reliable detailed accounts receivable information from the EXPERT system has negatively impacted our ability to estimate the approximate level of our allowances for uncollectible accounts, which contributed to a substantial increase in our allowance for uncollectible accounts.

*Regulatory Assets and Liabilities*

Our regulated operations are subject to the provisions of SFAS No. 71, *Accounting for the Effects of Certain Types of Regulations*. Our regulatory assets are the probable future revenues associated with certain costs to be recovered from customers through the ratemaking process. Regulatory liabilities are the probable future reductions in revenues associated with amounts to be credited to customers through the ratemaking process. If any part of our operations become no longer subject to the provisions of SFAS No. 71, the probable future recovery of or reduction in revenue with respect to the related regulatory assets and liabilities would need to be evaluated. In addition, we would need to determine if there was any impairment to the carrying costs of deregulated plant and inventory assets.



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While we believe that our assumption regarding future regulatory actions is reasonable, different assumptions could materially affect our results.

*Pension and Postretirement Benefit Plans*

With the acquisition of our Montana electric and natural gas transmission and distribution business from The Montana Power Company, our pension and other postretirement benefit obligations significantly increased. Our reported costs of providing pension and other postretirement benefits, as described in Note 13 of "Notes to the Consolidated Financial Statements" contained in Item 8, are dependent upon numerous factors resulting from actual plan experience and assumptions of future experience.

Pension and other postretirement benefit costs, for example, are impacted by actual employee demographics (including age and compensation levels), the level of contributions we make to the plans, earnings on plan assets, and health care cost trends. Changes made to the provisions of the plans may also impact current and future other postretirement benefit costs. Other postretirement benefit costs may also be significantly affected by changes in key actuarial assumptions, including anticipated rates of return on plan assets and the discount rates used in determining the postretirement benefit obligation and postretirement costs. Our expected rate of return on assets was 8.50% for 2002. A 6.50% discount rate was used to determine

our post-retirement benefit obligation as of December 31, 2002.

As a result of the factors listed above, significant portions of other postretirement benefit costs recorded in any period do not reflect (and are generally greater than) the actual benefits provided to pension plan participants.

Our pension and other postretirement benefit plan assets are primarily made up of equity and fixed income investments. Fluctuations in actual equity market returns as well as changes in general interest rates may result in increased or decreased pension and other postretirement benefit costs in future periods. Likewise, changes in assumptions regarding current discount rates and expected rates of return on plan assets could also increase or decrease recorded pension and other postretirement benefit costs.

***Qualifying Facilities Liability***

With the acquisition of our Montana electric and natural gas transmission and distribution business from The Montana Power Company, we assumed a liability for costs associated with certain Qualifying Facilities, or QFs. The QFs require us to purchase minimum amounts of energy at prices ranging from $65 to $138 per megawatt hour through 2029. Our gross contractual obligation related to the QFs is approximately $1.9 billion through 2029. A portion of the costs incurred to purchase this energy is recoverable through rates authorized by the MPSC, totaling approximately $1.5 billion through 2029. Upon completion of the purchase price allocation related to our acquisition of the electric and natural gas transmission and distribution business of The Montana Power Company, we established a liability of $134.3 million, based on the net present value of the difference between our obligations under the QFs and the related amount recoverable. The determination of the discount rate used to establish this liability was a significant assumption. We determined the appropriate discount rate to be 8.75%, in accordance with Statement of Financial Accounting Concepts No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*. We believe that 8.75% approximates the rate we could have negotiated with an independent lender for a similar transaction under comparable terms and conditions as of the acquisition date.

***Minority Interest in Consolidated Subsidiaries***

Substantially all of our acquisitions at Expanets and Blue Dot have involved the issuance of common and preferred stock in those subsidiaries to the sellers of the acquired businesses. In connection with certain acquisitions of Expanets and Blue Dot, the sellers can elect to exchange the



stock of Expanets and Blue Dot for cash or in certain circumstances, at the election of NorthWestern, shares of common stock of NorthWestern that have been registered for resale, at a predetermined exchange rate. Our investments in Expanets and Blue Dot are principally in the form of senior preferred stock with voting control and a liquidation preference over such common and preferred stock. We are required to consolidate the financial results of Expanets and Blue Dot because of our voting control. The common stock issued to third parties in connection with acquisitions creates minority interests which are junior to our preferred stock interests. Operating losses at Expanets and Blue Dot have been allocated first to the common shareholders of each subsidiary in proportion to common equity ownership to the extent the allocation does not exceed the minority interest of such common shareholders in the equity capital of the subsidiary after giving effect to any put options or exchange agreements, and thereafter is allocated to the preferred shareholders of each subsidiary in the order of priority equal to the liquidation preference of each series of preferred stock. Exchange agreements totaling $6.0 million for Expanets and $3.9 million for Blue Dot remained outstanding and were included in minority interests as of December 31, 2002. The equity held by third parties of these entities is as follows:

| | Third Party Equity Reflected as Minority Interests At December 31, | |
|---|---|---|
| | 2002 | 2001 |
| | (in thousands) | |
| Expanets | $ 5,972 | $ 17,124 |

| | | |
|---|---|---|
| Blue Dot | 3,868 | 12,439 |
| Other | 500 | 504 |
| Total | $ 10,340 | $ 30,067 |

See also "Liquidity and Capital Resources—Other Contractual Obligations" for discussion of additional equity instruments held by third parties that are not reflected in Minority Interests.

The Minority Interests in Net Loss of Consolidated Subsidiaries contained in our consolidated statements of income (loss) is the income (loss) of our subsidiaries which is allocable to minority interests. In order to determine the allocation of income (loss) to minority interests, preferred dividends and corporate services allocations are deducted from the income (loss) before minority interests reported in our segment disclosures in order to arrive at the Minority Interests in Net Loss of Consolidated Subsidiaries contained in our consolidated statements of income. The corporate allocations relate to certain services NorthWestern provides to its subsidiaries for management services, including insurance, legal, human resources and benefit administrative support for employee benefits, transaction structuring, financial analysis, tax services and information technology. These services are discussed in Note 2 "Significant Accounting Policies—Minority Interest in Consolidated Subsidiaries" to NorthWestern's annual consolidated financial statements. The preferred dividends relate to dividends on our 12% coupon Preferred Stock of Expanets and our 11% coupon Preferred Stock of Blue Dot. The preferred dividends and corporate allocations are eliminated in consolidation. The net income (loss) before minority interests and net income (loss) available to common equity holders reported in our segment disclosures includes the portion of interest expense on our $205.7 million intercompany balance due from Expanets which is allocable to third party minority interests.

The following tables demonstrate the reconciliation of income (loss) before minority interests reported in NorthWestern's segment disclosures for its communications and HVAC segments, the only two segments that have Minority Interest, to Minority Interests in Net Loss of Consolidated Subsidiaries contained in its consolidated statements of income for the periods indicated. All amounts in boxes are reflected directly within NorthWestern's consolidated financial statements. All other amounts support the derivation of those numbers.



Preferred dividends for the year ended December 31, 2002 of $39.8 million and $43.4 million for Blue Dot and Expanets, respectively, which were either paid in kind through the issuance of additional preferred stock or credited against intercompany balances, represent increases of $11.6 million and $10.3 million, respectively, which reflect increased investments by NorthWestern in the preferred stock of each entity. Corporate allocations for 2002 of $2.1 million and $4.2 million for Blue Dot and Expanets, respectively, represent decreases of $1.0 million and $3.8 million, respectively, from amounts in 2001. The decreases reflect decreased services provided by NorthWestern, which are now performed by and directly expensed by each entity.

| | Year ended December 31, 2002 | | |
|---|---|---|---|
| | HVAC (Blue Dot) | Communications (Expanets) | Total |
| | | (in thousands) | |
| Loss before minority interests | $ (320,745) | $ (445,582) (1) | $ (766,327) |
| Preferred dividends | (39,846) | (43,440) | (83,286) |
| Corporate allocations (partner billings) | (2,055) | (4,200) | (6,255) |
| Net loss available to common equity holders | $ (362,646) | $ (493,222) | $ (855,868) |
| Loss allocation to shareholders: | | | |
| NorthWestern | $ (358,884) | $ (482,070) | $ (840,954) |

| | | | |
|---|---|---|---|
| Minority interests | (3,762) | (11,152) | (14,914) |
| Total | $ (362,646) | $ (493,222) | $ (855,868) |

(1) Expanets' loss before minority interests includes $9.5 million of after tax interest expense on amounts due to NorthWestern.

Preferred dividends for the year ended December 31, 2001 of $28.2 million and $33.1 million for Blue Dot and Expanets, respectively, represent increases of $8.6 million and $7.2 million, respectively, which reflect increased investments by NorthWestern in the preferred stock of each entity. Corporate allocations for 2001 of $3.0 million and $8.0 million for Blue Dot and Expanets, respectively, represent increases of $0.7 million and $3.7 million, respectively, from amounts in 2000. The increase at Expanets is due to increased services provided by NorthWestern primarily related to the non-recurring transition and integration expenses related to the acquisition of the Lucent GEM assets. The increase at Blue Dot is due to continued increased involvement and corporate services provided by NorthWestern.

| | Year ended December 31, 2001 | | |
|---|---|---|---|
| | HVAC (Blue Dot) | Communications (Expanets) | Total |
| | | (in thousands) | |
| Loss before minority interests | $ (13,562) | $ (87,008) (1) | $ (100,570) |
| Preferred dividends | (28,192) | (33,062) | (61,254) |
| Corporate allocations | (3,047) | (7,971) | (11,018) |
| Net loss available to common equity holders | $ (44,801) | $ (128,041) | $ (172,842) |
| Loss allocation to shareholders: | | | |
| NorthWestern | $ (31,246) | $ (148) | $ (31,394) |
| Minority interests | (13,555) | (127,893) | (141,448) |
| Total | $ (44,801) | $ (128,041) | $ (172,842) |

(1) Expanets' loss before minority interests includes $4.4 million of after tax interest expense on amounts due to NorthWestern.



| | Year ended December 31, 2000 | | |
|---|---|---|---|
| | HVAC (Blue Dot) | Communications (Expanets) | Total |
| | | (in thousands) | |
| Loss before minority interests | $ (2,265) | $ (19,799) (1) | $ (22,064) |
| Preferred dividends | (19,570) | (25,907) | (45,477) |
| Corporate allocations | (2,324) | (4,264) | (6,588) |

| | | | |
|---|---|---|---|
| Net loss available to common equity holders | $ (24,159) | $ (49,970) | $ (74,129) |
| Loss allocation to shareholders: | | | |
| NorthWestern | $ (6,246) | $ (62) | $ (6,308) |
| Minority interests | (17,913) | (49,908) | (67,821) |
| Total | $ (24,159) | $ (49,970) | $ (74,129) |

(1) Expanets' loss before minority interests includes $0.4 million of after tax interest expense on amounts due to NorthWestern.

As of December 31, 2002, no remaining minority interest basis existed with respect to Blue Dot and Expanets against which losses could be allocated. Accordingly, any future losses at Blue Dot and Expanets will be recognized in our operating results. Different capital structures in the future or unanticipated future operating results, either positive or negative, could result in materially different results.

## RESULTS OF OPERATIONS

The following is a summary of our results of operations in 2002, 2001 and 2000. Our consolidated results include the results of our divisions and subsidiaries constituting each of our business segments. This discussion is followed by a more detailed discussion of operating results by segment. Our "All Other" category primarily consists of our other miscellaneous service activities, which are not included in the other identified segments together with unallocated corporate costs. See "—Segment Information—All Other Operations" for a discussion of the items contained in our "All Other" category. Product and service category fluctuations highlighted at the consolidated level are more fully explained in the segment discussion.

*Consolidated Earnings (Loss).*

Consolidated losses on common stock in 2002 were $892.9 million, compared to consolidated earnings on common stock in 2001 of $37.5 million. Diluted earnings per share, or EPS, in 2002 was $(30.04), a decline of $31.57, from 2001 results. The decline in earnings in 2002 is largely due to impairment charges of $301.7 million at Blue Dot, $288.7 million at Expanets and $35.7 million related to the Montana First Megawatts project. Also contributing to the loss were $101.7 million, net of taxes, of additional losses associated with the discontinued operations of CornerStone, $65.8 million related to billing adjustments and accounts receivable reserves and write-offs at Expanets, a deferred tax asset valuation allowance of $71.5 million, and an extraordinary charge of $13.4 million, net of taxes, related to refinancing debt. In addition, interest expense increased by $80.3 million, primarily related to financings to facilitate the acquisition of NorthWestern Energy's Montana operations. These amounts were offset partially by $30.7 million of increased earnings in our electric and natural gas operations due primarily to the acquisition of NorthWestern Energy's Montana operations. Consolidated earnings on common stock in 2001 were $37.5 million, a decline of $5.2 million, or 12.3%, from 2000 results. Consolidated earnings on common stock in 2001 were reduced by a $24.9 million restructuring charge ($12.1 million net of taxes and minority interests) taken in the fourth quarter. The 2001 restructuring charge reduced diluted EPS by $0.50 per share. The $24.9 million restructuring charge related principally to facility closure costs, employee termination benefits and related costs incurred in connection with a series of company wide initiatives targeting reductions in annualized selling, general and administrative expenses.



*Consolidated Operations.*

Consolidated revenues in 2002 were $1,991.5 million, an increase of $267.5 million, or 15.5%, from 2001. The increase in 2002 was due to an increase in revenues from the electric and natural gas operations of $524.2 million as a result of the

inclusion of NorthWestern Energy's Montana operations, a $48.0 million increase in revenues at Blue Dot, primarily due to acquisitions, and a $16.9 million increase in revenues from our All Other operations as a result of the addition of certain non-utility operations acquired with NorthWestern Energy's Montana operations. This increase was offset in part by a decrease in revenues at Expanets of $321.6 million as a result of the downturn in the economy and the telecommunications industry, certain data migration and system implementation problems at Expanets and a decrease in revenues at NorthWestern Energy's South Dakota and Nebraska operations of $32.1 million as a result of warmer weather in their service areas in 2002 and wholesale energy price decreases. Consolidated revenues in 2001 were $1,724.0 million, an increase of $14.5 million, or 0.8%, from 2000 results. The increase in 2001 was primarily due to increased revenues in our electric and natural gas segments of $69.9 million and increased revenues at Blue Dot of $15.0 million. This increase was partially offset by a decline in revenues at Expanets of $72.0 million as a result of the downturn in the economy and the telecommunications industry in particular, primarily due to volume declines.

Consolidated cost of sales in 2002 was $1,095.4 million, an increase of $26.1 million, or 2.4%, from 2001. NorthWestern Energy's Montana utility operations added $220.9 million in cost of sales and Blue Dot experienced a $38.7 million increase in cost of sales, which was partially offset by a $203.5 million decrease at Expanets, and a $24.3 million reduction in cost of sales at NorthWestern Energy's South Dakota and Nebraska utility operations. Consolidated cost of sales in 2001 was $1,069.4 million, a decline of $31.1 million, or 2.8%, from 2000 results. Expanets experienced a $92.5 million reduction in consolidated cost of sales. The reductions in cost of sales at Expanets were partially offset by increased cost of sales of $54.0 million in our electric and natural gas segments and increased cost of sales at Blue Dot of $7.0 million.

Consolidated gross margin in 2002 was $896.1 million, an increase of $241.5 million, or 36.9%, from 2001. The increase was primarily due to $341.7 million in gross margin from the inclusion of NorthWestern Energy's Montana utility operations, an increase of $22.7 million in gross margin from All Other operations and a $9.3 million increase in gross margin at Blue Dot. These increases were offset in part by a $118.0 million decrease in gross margin at Expanets and a $14.2 million decrease in gross margins at our NorthWestern Energy's South Dakota and Nebraska utility operations. Consolidated gross margin in 2001 was $654.6 million, an increase of $45.6 million, or 7.5%, from 2000 results. Gross margin in 2001 increased across all of our segments. Expanets' gross margin increased $20.5 million, primarily as a result of the full year impact of the Lucent GEM business operations in 2001, which were acquired in April 2000. Gross margin in our electric segment increased $14.2 million, primarily as a result of increased wholesale electric margins during the first half of 2001, and gross margin in our natural gas segment increased $1.8 million. Blue Dot's gross margin increased $8.0 million as a result of acquisitions in 2001.

Consolidated gross margin, as a percentage of revenues in 2002 was 45.0%, compared to 38.0% in 2001 and 35.6% in 2000. Increases in 2002 over 2001 were primarily provided by the inclusion of NorthWestern Energy's Montana electric, natural gas, and non-utility operations. Consolidated gross margin as a percentage of revenues in 2001 improved as a result of the gross margin gains described above, together with our efforts to reduce costs and increase higher-margin recurring service and maintenance revenues in our communications operations.

Consolidated operating expenses in 2002, which includes selling, general and administrative expenses, or SG&A, goodwill and long-lived asset impairment charges, depreciation and amortization, were $1,525.7 million, an increase of $774.2 million, or 103.0%, from 2001. This increase was primarily



due to goodwill and long-lived asset impairment charges of $301.7 million, $288.7 million and $35.7 million at Blue Dot, Expanets and All Other operations, respectively. Also contributing to this increase was the inclusion of $228.6 million in operating expenses, including $43.8 million of depreciation, from NorthWestern Energy's Montana utility operations. These increases were offset in part by a net decrease in SG&A, depreciation and amortization of $117.5 million at Expanets. Consolidated operating expenses in 2001 were $751.5 million, an increase of $146.8 million, or 24.3%, from 2000 results. Operating expenses increased in each of our segments in 2001 due in part to a $24.9 million restructuring charge related to our series of company wide initiatives targeting reductions in annualized selling, general and administrative expenses. Expanets incurred increased expenses of $92.6 million, excluding its portion of this restructuring charge of $5.9 million, related to additional Lucent GEM business operating costs together with additional non-capitalizable integration and transition costs. Blue Dot's operating expenses also increased $19.1 million, excluding its portion of this restructuring charge of $7.2 million, due to continued acquisition activities and infrastructure growth. The restructuring charges discussed above resulted in $3.3 million of the $6.2 million increase in operating expenses of our electric utility and $1.2 million of the

$1.9 million increase in operating expenses of our natural gas segment. All Other operating expenses increased $6.6 million excluding the $7.2 million restructuring charge due to personnel additions and professional services to support our expanding subsidiary operations.

Consolidated operating losses from continuing operations in 2002 were $629.6 million, an increase of $532.8 million from 2001. The increase in operating losses was primarily due to the impairment charges at Blue Dot, Expanets and All Other of $301.7 million, $288.7 million and $35.7 million, respectively, and a $14.0 million decrease in operating income at NorthWestern Energy's South Dakota and Nebraska utility operations, which was partially offset by the inclusion of $113.1 million of operating income from NorthWestern Energy's Montana utility operations. Consolidated operating losses from continuing operations in 2001 were $96.9 million, compared to consolidated operating income from continuing operations in 2000 of $4.3 million. The $101.2 million change in operating income was due to a $78.0 million increase in operating loss at Expanets, an $18.4 million decline in operating income at Blue Dot, and a $12.7 million increase in All Other operating loss. These losses were partially offset by an $8.0 million operating income increase within our electric segment.

Investment losses and other in 2002 was $5.4 million, a decrease of $13.4 million from investment income and other of $8.0 million in 2001. The decrease was primarily due to capital losses on miscellaneous investments. Investment income and other in 2001 decreased slightly to $8.0 million from $9.0 million in 2000. Gains from stock sales during the fourth quarter of 2001 were partially offset by realized losses on the write-down of certain investments. Overall investment income was also negatively impacted by lower interest rates and overall stock portfolio performance during 2001.

Consolidated interest expense in 2002 was $129.5 million, an increase of $80.3 million, or 163.0%, from 2001. The increase was primarily due to increased financings to facilitate the acquisition of NorthWestern Energy's Montana operations. Interest expense in 2001 was $49.2 million, an increase of $11.3 million, or 29.7%, from 2000 results. The increase in interest expense was primarily attributable to financings by Expanets, where interest expense increased $13.3 million, and was offset partially by a decrease in interest expense at Blue Dot resulting from reduced credit facility borrowings.

Consolidated income tax benefit in 2002 was $0.8 million, a decrease of $41.7 million from 2001. The decrease in the tax benefit was primarily related to a valuation allowance against the deferred tax assets and current net operating losses of Expanets and Blue Dot. The 2002 benefit has been reduced by a valuation allowance comprised of $121.6 million against the net deferred tax assets of Expanets and $27.9 million against the net deferred tax assets of Blue Dot, due to the significant losses of these subsidiaries. The valuation allowance has been established because management believes it is more likely than not that these deferred tax assets will not be realized. Consolidated income tax benefit in 2001 was $42.5 million, an increase of $36.0 million over the income tax benefit in 2000. Over 50% of



the increase resulted from the tax benefit at Expanets, which was the result of a significant increase in operating losses in 2001. Lower taxable income at Blue Dot as a result of operating losses further increased the benefit, as did higher All Other operating expenses. The income tax benefits were partially reduced by increased tax expense at our electric and natural gas segments.

Minority interests represent the net income or loss, after preferred dividends and corporate allocations related to our preferred stock investments in Expanets and Blue Dot, which are allocable to common shareholders other than us. Minority interests in 2002 were $14.9 million, a decrease of $126.5 million, or 89.5%, from 2001. The decrease was due to the depletion of available minority interest basis against which to allocate losses of Expanets and Blue Dot. After March 31, 2002, all losses were fully allocated to NorthWestern. Minority interests in 2001 were $141.4 million, an increase of $73.6 million, or 108.6%, from 2000. All of the increase was due to Expanets, where losses increased substantially in 2001, which was partially offset by reduced allocations at Blue Dot due to reduction in available basis to absorb the losses. Due to adequate basis in 2001 and 2000, substantially all losses by Expanets and Blue Dot were allocated to minority interests. Based on the entities' capital structures at December 31, 2002, any future losses at Expanets and Blue Dot will be allocated to us. See "—Critical Accounting Policies and Estimates—Minority Interest in Consolidated Subsidiaries" for a discussion of the allocation of income (loss) to minority interests and the changes in such allocations during the periods discussed.

***Electric Utility Segment Operations.***

Revenues from our electric utility operations in 2002 were $535.0 million, an increase of $428.0 million, or 400.1%, from 2001 results. This increase was almost exclusively attributable to the addition of NorthWestern Energy's Montana operations, effective February 1, 2002, which contributed $442.5 million of revenues for the year. The volume of wholesale and retail megawatt hours sold in 2002 for our Montana operations was 1.4 million and 6.7 million, respectively. In addition, our South Dakota operations contributed revenues of $92.5 million for 2002, which was a decrease of $14.5 million, or 13.5%, from 2001. This decrease in revenues was principally the result of a decrease of $16.1 million in wholesale electric revenues within the South Dakota operations due to market price declines. The volume of wholesale megawatt hours sold in 2002 for our South Dakota operations decreased by 6.2%, however, the volume of retail megawatt hours sold increased by 0.3%. Revenues from our electric utility operations in 2001 were $107.0 million, an increase of $20.4 million, or 23.6%, from 2000 results. The increase in revenues was principally the result of increased wholesale market prices for electricity. Revenues from our wholesale sales of electricity in 2001 were $13.6 million greater than the $9.3 million of revenues generated from such sales in 2000. The increase in wholesale sales revenues was principally due to unusual market conditions during the first half of 2001, and was partially offset by lower sales volume. The volume of wholesale megawatt hours sold in 2001 decreased by 3.4%; however, the volume of retail megawatt hours sold in 2001 increased by 4.4%. Revenues from retail sales of electricity increased by 8.9% in 2001, from $77.3 million in 2000 to $84.2 million in 2001. The increase in retail sales revenue in 2001 was principally due to a growing customer base combined with higher fuel costs that are passed through to customers.

Cost of sales for our electric utility operations in 2002 was $205.6 million, an increase of $182.6 million, or 791.9%, from 2001 results. This increase was nearly all due to the addition of NorthWestern Energy's Montana operations, which increased costs by $182.0 million. In addition, our South Dakota operations experienced a $0.6 million increase in costs related to the increase in sales volume. The cost of sales for our electric utility operations in 2001 was $23.1 million, an increase of $6.3 million, or 37.4%, from 2000 results. The increase in cost of sales in 2001 was due principally to retail fuel cost adjustments and increased volumes.

Gross margin in 2002 was $329.4 million, an increase of $245.5 million, or 292.5%, over the 2001 gross margin of $83.9 million. This increase was primarily due to the contribution of $260.5 million in



gross margin from NorthWestern Energy's Montana operations. Partially offsetting this increase was a decrease in gross margin by our South Dakota operations of $15.0 million, or 17.9%, as a result of a substantial decrease in market prices for wholesale electricity as compared to the unusually high market prices in 2001. Overall gross margin as a percentage of revenues in 2002 was 61.6%, as compared to 78.5% in 2001. This decrease was the result of the substantial decline in wholesale electric margins from market price fluctuations and the influence of NorthWestern Energy's lower margin Montana operations as compared to our South Dakota operations. Gross margin in 2001 was $83.9 million, an increase of $14.2 million, or 20.3%, over the 2000 gross margin of $69.8 million. The increase in gross margin in 2001 resulted primarily from the unusual wholesale market conditions and the 4.4% increase in retail sales. Gross margin as a percentage of revenues in 2001 was 78.5%, compared to 80.6% in 2000, a decrease primarily as a result of increased fuel costs in 2001.

Operating expenses, consisting of selling, general and administrative (SG&A) and depreciation expenses, were $218.3 million in 2002, an increase of $174.1 million, or 393.3%, over the 2001 results. This increase was nearly all due to the addition of NorthWestern Energy's Montana operations, which increased SG&A costs by $141.9 million and increased depreciation expense by $35.4 million. Partially offsetting this increase was a decrease in SG&A of $3.5 million by our South Dakota operations, resulting primarily from operational efficiencies, a reduction in benefit costs, the establishment of a capital lease for our lease programs, and the occurrence in 2001 of a restructuring charge. Operating expenses in 2001 were $44.3 million, an increase of $6.2 million, or 16.3%, from 2000 results. This increase was primarily caused by a restructuring charge of $3.3 million, together with small increases in allocated power plant maintenance costs associated with increased generation, higher team member benefits expenses, increased customer service costs and higher depreciation related to additional investments in power plants. Higher operating expenses in 2001 were partially offset by lower transmission and distribution expenses.

Operating income in 2002 was $111.1 million, an increase of $71.4 million, or 180.0%, over 2001. The increase was attributable to the addition of approximately $83.2 million in operating income from NorthWestern Energy's Montana operations, while the South Dakota operations experienced a decrease of $11.8 million in operating income from the absence of unusually high margin wholesale electric sales in 2002 countered, in part, by lower operating expenses in 2002. Operating income in 2001 was $39.7 million, or $43.0 million before restructuring charges, representing an increase of $8.0 million, or

25.1%, over 2000. The increase in operating income was a result of increased higher margin wholesale sales revenue, partially offset by higher operating expenses in 2001.

*Natural Gas Utility Segment Operations.*

Revenues from our natural gas utility operations in 2002 were $240.3 million, an increase of $96.1 million, or 66.6%, from 2001 results. Revenues for the period reflect the inclusion of NorthWestern Energy's Montana operations, which contributed $120.1 million in revenues. In addition, our South Dakota operations contributed revenues of $120.2 million for 2002, which was a decrease of $24.0 million, or 16.7%, from 2001. This decrease was principally the result of a drop in commodity prices reflected within the South Dakota operations during 2002 compared to 2001, and a decrease in volumes as a result of warmer weather in the Nebraska and South Dakota service territories in 2002 than in 2001. Revenues from natural gas sales in 2001 were $144.2 million, an increase of $49.5 million, or 52.2%, from 2000 results. The increase was largely attributable to higher market prices for natural gas and a slight increase in the volume of sales.

Cost of sales for our natural gas utility operations in 2002 was $133.1 million, an increase of $14.1 million, or 11.8%, from the 2001 results. Cost of sales for the period reflect the inclusion of NorthWestern Energy's Montana operations, which contributed $38.9 million in cost of sales, and a decrease in cost of sales from our South Dakota business of $24.9 million, or 20.9%. This decrease occurred primarily as a result of lower commodity prices and reduced retail volumes from warmer



weather in 2002 than in 2001. Cost of sales in 2001 was $119.1 million, an increase of $47.7 million, or 66.8%, from 2000 results. The increase in cost of sales was a result of the increased market prices for natural gas in 2001 and, to a lesser extent, the slight increase in our volume of sales.

Gross margin in 2002 was $107.2 million, an increase of $82.0 million, or 326.2%, over the 2001 gross margin of $25.2 million. This increase was nearly all due to the contribution of $81.2 million in gross margin by NorthWestern Energy's Montana operations. In addition, our South Dakota operations experienced a $0.8 million increase in margins due to increased volumes in the non-regulated gas segment. Overall gross margin as a percentage of revenues in 2002 was 44.6%, as compared to 17.4% in 2001, resulting primarily from the higher margin impact from the Montana operations. The higher margins from the Montana operations are principally due to NorthWestern owning the natural gas transmission system in Montana on which we collect tariff revenues and margins, as compared to South Dakota and Nebraska operations where third parties own the transmission systems and NorthWestern pays these costs which are then passed on to ratepayers as a component of the natural gas costs. Gross margin in 2001 was $25.2 million, an increase of $1.8 million, or 7.7%, from 2000 results. However, gross margin as a percentage of revenues decreased to 17.4% in 2001 from 24.7% in 2000. The increase in gross margin in 2001 was due to increased sales volumes and higher market prices for natural gas in 2001. Because the higher market prices for natural gas were passed along to consumers, the increase in gas commodity prices did not affect gross margin, but did have a positive impact on revenues and, therefore, adversely affected the gross margin percentage.

Operating expenses in 2002 were $73.3 million, an increase of $54.4 million, or 286.8%, over 2001 results. SG&A expenses increased $45.0 million in 2002, primarily due to $42.9 million in additional expenses attributable to NorthWestern Energy's Montana operations, while the South Dakota operations' SG&A expenses increased by $2.1 million. Depreciation expense was $12.6 million in 2002, an increase of $9.3 million over 2001. This increase was also primarily due to the addition of NorthWestern Energy's Montana operations, which increased depreciation by $8.3 million, along with an increase of $1.0 million from our South Dakota operations. Operating expenses in 2001 were $19.0 million, an increase of $1.9 million, or 11.0%, from 2000 results. The increase was due principally to a $1.2 million restructuring charge related to a series of company wide initiatives targeting reductions in annualized selling, general and administrative expenses and small increases in team member benefit costs, customer care costs, and service expenses.

Operating income in 2002 was $33.9 million, an increase of $27.7 million, or 446.7%, from 2001, primarily due to the addition of NorthWestern Energy's Montana operations, which contributed $30 million in operating income, while operating income from the South Dakota operations declined by $2.3 million. Operating income in 2001 was $6.2 million, or $7.4 million before restructuring charges, compared to operating income in 2000 of $6.3 million. The increase in operating income in 2001 before restructuring charges reflected gross margin increases, but was partially offset by increased operating expenses.

*Communications Segment Operations*

Operating revenues at Expanets in 2002 were $710.5 million, a decrease of $321.6 million, or 31.2%, from 2001. The decline in revenue was the result of a downturn in the economy generally and the telecommunications equipment market specifically, a focus on higher margin revenues and continuing problems with Expanets' EXPERT system implementation that have contributed to erosion of Expanets' customer base. Expanets recorded a reduction in revenues of $28.0 million for pending billing adjustments.

Cost of sales in 2002 was $444.5 million, a decrease of $203.5 million, or 31.4% from 2001. The decrease was primarily due to lower sales volume and a technical assistance call center agreement signed with Avaya in March 2002 which reduced costs by approximately $25.9 million during the year



ended December 31, 2002. Cost of sales in 2001 was $648.0 million, a decline of $92.5 million, or 12.5%, from 2000 results. The decline in cost of sales was attributable to a shift in sales mix from equipment sales to higher-margin service sales and a decline in sales volumes.

Gross margin in 2002 was $265.9 million, a decrease of $118.1 million, or 30.7%, from 2001. Gross margin dollars decreased as the result of a decrease in revenue. As a percentage of revenues, gross margin increased slightly to 37.4% of operating revenues as compared to 37.2% in 2001. Gross margin in 2001 was $384.0 million, an increase of $20.5 million, or 5.6%, from 2000 results. As a percentage of revenues, gross margin increased from 32.9% in 2000 to 37.2% in 2001. Gross margin dollars increased, in spite of an overall decline in operating revenues, as the result of increased solutions and services sales. The gross margin percentage improvement was a result of the increased mix of higher margin recurring service revenues as compared to lower margin equipment sales.

Operating expenses in 2002 were $657.8 million, a decrease of $171.3 million, or 35.2%, from 2001. Selling, general and administrative expenses in 2002 were $314.0 million, a decrease of $123.4 million, or 28.2% from 2001. This decrease was a result of the full year effect of the reduction of approximately 1,300 team member positions in 2001. In addition, current year operating expenses decreased as certain transition service agreements, or TSAs, with Avaya expired or were terminated. Under these TSAs, Avaya provided critical supporting systems such as accounting and information technology until Expanets could complete the necessary infrastructure to provide such services internally. Also contributing to the decrease, Expanets receives payments from Avaya under the terms of a maintenance fee agreement to help Avaya preserve its maintenance customer base for customers of Expanets who have maintenance agreements with Avaya. These amounts reduced operating expenses by $42.8 million in 2002 and $32.0 million in 2001. Included in the amount recognized in 2002 was a true up payment of $2.4 million from Avaya and an additional $10.4 million that had previously been deferred as of December 31, 2001, pending the determination of Avaya's actual experience. In addition, Expanets reduced accrued expenses established as of December 31, 2001 related to vendor settlements, bonus accruals and other items by $11.2 million during 2002. The decrease in selling, general and administrative expenses was partially offset by $37.4 million in bad debt expense and other receivable related charges and $31.2 million of additional expense associated with information technology costs for the operation and repair of the EXPERT system. Depreciation and amortization costs increased approximately $5.9 million in 2002 as the capitalized costs of the EXPERT system were depreciated starting in the first quarter of 2002. Operating expenses in 2001 were $486.5 million, an increase of $98.5 million, or 25.4%, from 2000 results. Selling, general and administrative expenses in 2001 were $437.4 million, an increase of $86.5 million, or 24.6%, from 2000 results. The increase in selling, general and administrative expenses in 2001 was primarily a result of the additional transition and integration and other operating expenses related to the Lucent GEM business acquisition beginning in the second quarter of 2000.

Operating losses in 2002 were $391.9 million, an increase of $289.3 million from 2001 results, primarily due to a decline in the telecommunications equipment market and the $288.7 million in impairment charges discussed above. Operating losses in 2001 were $102.6 million, a decline of $78.0 million from 2000 results, primarily due to the general downturn in the economy and in the communications market in particular, together with the additional integration/transition and other operating expenses incurred as a result of the GEM acquisition.

*HVAC Segment Operations*

Operating revenues in 2002 were $471.8 million, an increase of $48.0 million, or 11.3% from 2001 results. Units

acquired in 2002 and 2001 contributed $41.8 million in revenues in 2002. The remaining increase of $6.2 million represents a same unit growth rate of 1.5%. Operating revenues from non-core same units, which are operating locations designated by management of Blue Dot for immediate divestiture or closure due to significant operating issues or continuing deterioration of performance,



were $74.0 million, a decrease of $12.6 million, or 14.5%, from 2001 results. The decline in revenues from the non-core units are due to soft overall market conditions in addition to individual circumstances which include: increased competition in Dallas; a shift in business focus from commercial to residential in San Antonio; disruption caused by labor issues in Detroit; changes in management at certain locations; and the continual impact of poor integration of businesses in New Jersey. Operating revenues in 2001 were $423.8 million, an increase of $15.0 million, or 3.7%, from 2000 results. Operations from acquisitions completed during 2001 and the inclusion of the operations for the full year in 2001 of the acquisitions made in the fourth quarter of 2000 contributed approximately $25.0 million in revenues, however, revenues at three previously acquired locations declined $26.4 million during 2001. Internal growth within the remainder of the HVAC business generated the remaining revenue increase.

Cost of sales in 2002 was $306.7 million, an increase of $38.7 million, or 14.4%, from 2001 results. Units acquired in 2002 and 2001 incurred costs of $28.3 million in 2002. Cost of sales in same units increased $11.3 million or 4.2%. This increase is primarily attributable to increased competition, compounded by soft market conditions. Cost of sales from non-core same units were $47.2 million, a decrease of $8.6 million, or 15.5% from 2001 results. This decrease is generally in line with the decrease in revenues noted from these same operating units. Cost of sales in 2001 was $268.0 million, an increase of $7.0 million, or 2.7%, from 2000 results. The acquisition and operations of locations in 2001 and the inclusion of the operations for the full year in 2001 of the locations acquired in the fourth quarter of 2000 increased costs by approximately $13.7 million. Costs from additional locations were offset, however, by $16.2 million in reduced cost of sales in connection with division closings and restructurings at three non-core locations. The remaining increase in cost of sales was due to internal growth in other locations.

Gross margin in 2002 was $165.2 million, an increase of $9.3 million, or 6.0%, from 2001 results. Units acquired in 2002 and 2001 contributed $15.6 million to gross margin in 2002. Gross margin in same units decreased $5.2 million or 3.4%. Gross margin from non-core same units were $26.7 million, a decrease of $3.9 million, or 12.8% from 2001 results. Gross margin in 2001 was $155.8 million, an increase of $8.0 million, or 5.4%, from 2000 results. The acquisition and operations of locations in 2001 and the inclusion of the operations for the full year in 2001 of the acquisitions made in late 2000 contributed approximately $11.3 million to gross margin in 2001, while certain non-core locations lowered gross margin $10.2 million. The remainder of the increase in gross margin in 2001 was due to internal growth in the previously acquired locations.

Gross margin as a percentage of revenues in 2002 decreased from 36.8% to 35.0%. Units acquired in 2002 and 2001 contributed gross margin as a percentage of revenues of 35.5%, while gross margin as a percentage of revenues from same units decreased from 36.7% to 35.0%, primarily due to general economic conditions, a tougher competitive environment and increased operating costs.

Operating expenses in 2002 were $476.5 million, an increase of $306.9 million from 2001 results. The primary reason for this increase was goodwill and long-lived asset impairment charges of $301.7 million. These impairment charges were recorded during the fourth quarter of 2002 to write off the carrying value of goodwill, fixed assets and intangible assets based on the fair value of Blue Dot, determined in accordance with SFAS No. 142 and SFAS No. 144, respectively. The charges are composed of $289.6 million for goodwill, $11.4 million for fixed assets and $0.7 million for intangible assets. Selling, general and administrative expenses in 2002 were $166.3 million, an increase of $13.1 million, or 8.6%, from 2001 results. Approximately $13.3 million of the expenses were incurred in connection with acquisitions in 2002 and the inclusion of the operations for the full year in 2002 of the acquisitions made in late 2001. Expenses increased $5.2 million in 2002 related to the sale-leaseback of a significant portion of Blue Dot's vehicle fleet. Expenses also increased $3.5 million in 2002 at the corporate level related to transition costs of relocating the corporate office, outside consulting, and additional costs of adding team members to support field operations and newly acquired locations.

Depreciation and amortization expenses in 2002 were $8.5 million, a decrease of $7.9 million, due to implementation of SFAS No. 142 related to the non-amortization of goodwill and reduced depreciation expense of $3.8 million related to the sale-leaseback of a significant portion of the company's vehicle fleet, partially offset by continued acquisition activity and capital expenditures. Operating expenses in 2001 were $169.6 million, an increase of $26.3 million, or 18.4%, from 2000 results. Selling, general and administrative expenses in 2001 were $153.2 million, an increase of $23.7 million, or 18.3%, from 2000 results. Approximately $8.2 million of the additional expenses were incurred in connection with acquisitions in 2001 and the inclusion of the operations for the full year in 2001 of the acquisitions made in late 2000. Expenditures also increased $2.7 million in 2001 at the corporate level for salaries and benefits of additional team members to support field operations. The remaining increase in expenses was attributable to the growth of previously acquired locations. Blue Dot recorded a $7.2 million restructuring charge in 2001, which related primarily to severance and related team member benefits. Depreciation and amortization expenses in 2001 increased 18.9% due to the continued acquisition activity and capital expenditures.

Operating losses in 2002 were $311.3 million, an increase of $297.5 million from 2001 results primarily due to the impairment charges discussed in the previous paragraph. Prior to giving effect to these impairment charges, acquisitions in 2002 and the inclusion of the operations for the full year in 2002 of the acquisitions made in 2001 increased earnings by approximately $1.8 million. Prior to giving effect to these impairment charges, operating losses in 2002 from same units was $11.9 million, an improvement of $2.3 million or 16.1% from 2001 results. Prior to giving effect to these impairment charges, operating losses from non-core same units were $8.7 million, an improvement of $1.1 million, or 11.3% from 2001 results. The combination of a more competitive climate, increasing operating costs, transition costs related to the relocation of the corporate office resulted in the operating losses in 2002. Operating losses in 2001 were $13.8 million, a decline of $18.4 million from 2000 results. Acquisitions in 2001 and the inclusion of the operations for the full year in 2001 of the acquisitions made in 2000 increased earnings by approximately $3.1 million, but the restructuring charge of $7.2 million, decline in operating income within three non-core locations, margin shortfalls and an overall increase in operating expenses resulted in the net decline and operating loss in 2001.

***All Other Operations***

All Other primarily consists of our other miscellaneous service activities that are not included in the other identified segments, together with the unallocated corporate costs and investments, and any eliminating amounts. The miscellaneous service activities principally include non-utility businesses engaged in voice and data networks and systems, and a portfolio of services to residential and business customers, including product sales and maintenance contracts in areas such as home monitoring devices and appliances. In addition, the 2002 results include the non-utility operations from the newly acquired Montana business. Those activities include an underground pipe and line locating service as well as a portfolio of other services to residential and business customers.

Revenues for the segment in 2002 were $33.9 million, an increase of $16.9 million, or 100%, from 2001. The increase was due to $27.9 million from the newly acquired Montana non-utility operations offset by reduced revenues from the South Dakota and Nebraska non-utility voice and data networks business, which was transferred to Expanets mid-year. Revenues in 2001 were $16.9 million, an increase of $1.6 million, or 10.7%, from 2000 results. The growth in 2001 was attributable to a small acquisition closed in December 2000, which was partially offset by business restructurings and reductions within certain other service activities.

Cost of sales in 2002 was $5.5 million, a decrease of $5.8 million, or 51.2%, from 2001. The decrease was primarily due to the mid-year transfer of the South Dakota and Nebraska non-utility voice and data networks business. Cost of sales in 2001 was $11.2 million, an increase of $0.4 million, or 4.0%, from 2000 results. The increase was a result of the aforementioned acquisition offset by decreased costs from reductions in other service activities.



Gross margin in 2002 was $28.4 million, an increase of $22.7 million, or 397.7%, from 2001. The increase was primarily due to the newly acquired Montana non-utility operations offset by transfer of the previously mentioned South Dakota and Nebraska non-utility voice and data networks business to Expanets. Gross margin in 2001 was $5.7 million, an increase of $1.2 million from 2000 results. As a percentage of revenues, gross margin improved from 29.4% in 2000 to 33.7% in 2001 to 83.8% in 2002. The increase in 2002 resulted primarily from the newly acquired underground line locating service business.

Operating expenses in 2002 were $99.8 million, an increase of $67.7 million, or 210.5%, from 2001. The increase was primarily due to $35.7 million asset impairment charges with respect to the investment in the Montana First Megawatts project and operating expenses from the newly acquired underground line locating service business and to the recognition of expenses of approximately $5.9 million related to the anticipated termination of NorthWestern's Stock Ownership Plan. Operating expenses in 2001 were $32.1 million, an increase of $13.9 million, or 76.4%, from 2000 results. The increase was due principally to $7.3 million of restructuring charges related to a series of company wide initiatives targeting reductions in annualized selling, general and administrative expenses, increased salaries, benefits and relocation expenses related to additional personnel in the corporate offices, additional costs from the acquisition, increased professional services expenses, and an increase in certain other benefit plan expenses.

Operating losses in 2002 were $71.4 million, an increase of $45.0 million, or 170.1%, from 2001. The increase was primarily due to the previously mentioned asset impairment charges. Losses in 2001 were $26.4 million, compared to losses of $13.7 million in 2000. The $12.7 million increase in operating losses in 2001 was attributable to the restructuring charges together with growth in corporate operating expenses, which were partially offset by an increase in gross margin.

## LIQUIDITY AND CAPITAL RESOURCES

The success of our turnaround plan is dependent upon reducing our debt. Absent the receipt of significant proceeds from the sale of non-core assets, the raising of additional capital or a restructuring of our debt, we will not have the ability to materially reduce our debt or meet our significant maturing debt obligations beginning in 2005, and our ability to fund our operations and service our substantial indebtedness will be adversely affected.

As of December 31, 2002, cash and cash equivalents were $45.6 million, compared to $34.8 million at December 31, 2001. On April 7, 2003, cash and cash equivalents were approximately $95 million. The increase in cash is principally the result of the net proceeds received from the closing of our new senior secured term loan net of other debt principal payments and working capital needs. Our principal sources of liquidity for the year ended December 31, 2002 were cash from operations and cash provided by financing activities, including the sale of new debt and equity securities and borrowings under our former senior credit facility.

We realized net positive cash inflows from operations of $34.0 million in 2002, $83.2 million in 2001, and $34.7 million in 2000. Net cash provided by operating activities in 2002 was composed of a net loss of $863.9 million adjusted for non-cash items of $952.5 million, net cash provided by changes in operating assets and liabilities of $5.7 million and cash used for changes in net assets of discontinued operations of $60.2 million. The increase in cash flows in 2002 was due in part to a $42.0 million decrease in accounts receivable and a $35.8 million decrease in other current assets, offset primarily by a $50.7 million decrease in accounts payable and an $80.6 million decrease in cash due to changes in regulatory assets and liabilities. The increase in cash flows in 2001 was due in part to a $63.5 million increase in accrued expenses, a $51.0 million increase in accounts payable, a $32.3 million decrease in net assets of discontinued operations and a $6.4 million decrease in accounts receivables which were partially offset by a $19.0 million increase in other current assets and a $16.0 million increase in inventories. In 2002, we used our cash from operations and $631.0 million in cash provided from



financing activities, to fund $654.3 million in investment activities, including our acquisitions and capital expenditures. In 2001, we used our cash from operations, together with $8.6 million in existing cash and cash equivalents and $91.3 million in cash provided from financing activities, to fund $183.1 million in investment activities, including our acquisitions and capital expenditures. In 2000, we used a portion of our cash from operations, together with $150 million in cash provided from financing activities, to fund $163.9 million in investment activities, including our acquisitions and capital expenditures.

Cash flows used in investing activities in 2002 were $654.3 million, an increase of $471.2 million from 2001. The increase was primarily due to the acquisition of our Montana utility operations. Cash flows used in investing activities of $183.1 million in 2001 increased $19.2 million over 2000 investing activities. The increase was principally a result of increased growth of property, plant and equipment capital expenditures. Cash flows provided by financing activities in 2002 were $631.0 million, an increase of $539.7 million from 2001. The increase was primarily due to the issuance of $738.1 million in senior notes and other long-term debt, $123 million in net line of credit borrowings, $117.8 million in net proceeds from the issuance of preferred securities of subsidiary trusts and $81 million in net proceeds from the issuance of our capital stock, offset primarily by repayment of $313.5 million in long-term debt. Cash flows provided by financing activities of $91.3 million in 2001 declined $58.7 million compared to $150 million of financing cash inflows in 2000. The

In June 2001, the Financial Accounting Standards Board issued SFAS No. 143, *Accounting for Asset Retirement Obligations*, which was effective January 1, 2003. The statement provides accounting and disclosure requirements for retirement obligations associated with long-lived assets. The statement requires the present value of future retirement costs for which the Company has a legal obligation be recorded as liabilities with an equivalent amount added to the asset cost and depreciated over the asset life.

We have completed an assessment of the specific applicability and implications of SFAS No. 143. We have identified, but have not recognized, asset retirement obligation, or ARO, liabilities related to our electric and natural gas transmission and distribution assets. Many of these assets are installed on easements over property not owned by the Company. The easements are generally perpetual and only require retirement action upon abandonment or cessation of use of the property for the specified purpose. The ARO liability is not estimable for such easements as we intend to utilize these properties indefinitely. In the event we decide to abandon or cease the use of a particular easement, an ARO liability would be recorded at that time.

Our regulated utility operations have, however, previously recognized removal costs of transmission and distribution assets as a component of depreciation in accordance with regulatory treatment. To the extent these amounts do not represent SFAS No. 143 legal retirement obligations, they are to be disclosed as regulatory liabilities upon adoption of the statement. As of December 31, 2002, we have estimated accrued removal costs related to our Montana transmission and distribution operations in the amount of $111.0 million and $4.5 million, for our South Dakota and Nebraska operations, respectively, all of which are included in accumulated depreciation.

For our generation properties, we are in the process of evaluating the associated retirement costs as defined by SFAS No. 143 and what the prescribed accounting treatment will be under FERC rules. We have accrued decommissioning costs since the generating units were first put into service in the amount of $11.4 million, which is classified as an other noncurrent liability. Preliminary estimates indicate that this amount would be sufficient to cover the legally required retirement obligations.

SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, was issued in October 2001 and establishes a single accounting model for long-lived assets to be disposed of by sale. SFAS No. 144 requires that long-lived assets to be disposed of by sale be measured at the lower of the carrying amount or fair value less cost to sell, whether reported in continuing operations or discontinued operations. SFAS No. 144 also expands the reporting of discontinued operations to include components of an entity that have been or will be disposed of rather than limiting such discontinuance to a segment of a business. Our accounting for the discontinued operations of CornerStone as described in Note 6, "Discontinued Operations", followed the provisions of SFAS No. 144. We adopted SFAS No. 144 effective January 1, 2002. The adoption of SFAS No. 144 did not have a material impact on our consolidated results of operations, financial position, or cash flows as the long-lived asset impairment provisions of SFAS No. 144 effectively carried over the provisions of SFAS No. 121.

SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*, was issued in April 2002. SFAS No. 145 eliminates the requirement that gains and losses from the extinguishments of debt be aggregated and classified as extraordinary items, net of the related income tax. It also requires sale-leaseback treatment for certain modifications of a capital lease that result in the lease being classified as an operating lease. We will adopt SFAS No. 145 on January 1, 2003. As a result of the adoption, effective January 1, 2003, we will be required



to reflect the extraordinary loss on debt extinguishments of $13.5 million, net of tax, incurred in 2002 as part of continuing operations.

SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, was issued in June 2002. SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan, including lease termination costs and certain employee termination benefits that are associated with a restructuring, discontinued operation, plant closing or other exit or disposal activity. SFAS No. 146 will be applied prospectively and is effective for exit or disposal activities that are initiated after December 31, 2002. We will adopt SFAS No. 146 on January 1, 2003.

FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45), was issued in November 2002. FIN 45 elaborates on the existing disclosure requirements for most guarantees. It also clarifies that at the time a company issues a guarantee, the company must recognize an initial liability for the fair market value of the obligations it assumes under that guarantee and must disclose that information in its interim and annual financial statements. The initial recognition and measurement provisions of the FIN 45 apply on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure requirements of FIN 45 have been included in Note 19, Guarantees, Commitments and Contingencies.

SFAS No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure—an Amendment of FASB Statement No. 123*, was issued in December 2002. It provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. SFAS No. 148 is effective for fiscal years beginning after December 15, 2003. The impact of the statement on our results of operations and financial position is currently under review by management.

FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46), was issued in January 2003. This interpretation changes the method of determining whether certain entities, including securitization entities, should be included in a company's Consolidated Financial Statements. An entity is subject to FIN 46 and is called a variable interest entity, or VIE, if it has equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, or equity investors that cannot make significant decisions about the entity's operations, or that do not absorb the expected losses or receive the expected returns of the entity. All other entities are evaluated for consolidation in accordance with SFAS No. 94, *Consolidation of All Majority-Owned Subsidiaries*. A VIE is consolidated by its primary beneficiary, which is the party involved with the VIE that has a majority of the expected losses or a majority of the expected residual returns or both. The provisions of the interpretation are to be applied immediately to VIEs created after January 31, 2003, and to VIEs in which an enterprise obtains an interest after that date. For VIEs in which an enterprise holds a variable interest that it acquired before February 1, 2003, FIN 46 applies in the first fiscal period beginning after June 15, 2003. For any VIEs that must be consolidated under FIN 46 that were created before February 1, 2003, the assets, liabilities and non-controlling interest of the VIE would be initially measured at their carrying amounts with any difference between the net amount added to the balance sheet and any previously recognized interest being recognized as the cumulative effect of an accounting change. If determining the carrying amounts is not practicable, fair value at the date FIN 46 first applies may be used to measure the assets, liabilities and non-controlling interest of the VIE. FIN 46 also mandates new disclosures about VIEs, some of which are required to be presented in financial statements issued after January 31, 2003. We have evaluated the impact of FIN 46 to determine if we have any investments qualifying as VIEs and do not believe we have any VIEs. The rules are recent and, accordingly, they contain provisions that the accounting profession continues to analyze.



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## RISK FACTORS

You should carefully consider the risk factors described below, as well as other information included in this Annual Report on Form 10-K, before making an investment in our common stock or other securities. The risks and uncertainties described below are not the only ones facing our company. Additional risks and uncertainties not presently known or that we currently believe to be less significant may also adversely affect us.

**We have substantial indebtedness, which could adversely affect our financial condition.**

We had total consolidated indebtedness, including indebtedness with respect to mandatorily redeemable preferred securities of subsidiary trusts, of approximately $2.2 billion outstanding as of March 31, 2003.

Our indebtedness could have important consequences to you. For example, it could:

- increase our vulnerability to general adverse economic and industry conditions;
- require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of cash flow to fund working capital, capital expenditures and other general corporate purposes;

- limit our flexibility in planning for, or reacting to, changes in our business and the industries in which we operate;
- result in vendors requiring additional credit support, such as letters of credit, in order for us to utilize trade credit;
- place us at a competitive disadvantage compared to our competitors that have less debt; and
- limit our ability to borrow additional funds.

In addition, our failure to comply with any of the covenants contained in the instruments governing our indebtedness could result in an event of default which, if not cured or waived, could result in the acceleration of other outstanding indebtedness. We may not have sufficient working capital to satisfy our debt obligations in the event of an acceleration of all or a significant portion of our outstanding indebtedness.

**Our ability to implement our turnaround plan is subject to many impediments and uncertainties. A failure to completely implement our turnaround plan could have a material adverse affect on our results of operations and liquidity.**

Management is implementing a turnaround plan that includes these principal elements:

- focus on our core utility business;
- reduce our indebtedness; and
- sale or dispositions of our non-core assets.

Absent proceeds from the sale of non-core assets or significant improvements in the operating results of our non-energy businesses, we will not have the ability to materially reduce our debt. Therefore, our ability to implement this plan is subject to many impediments and uncertainties including:

- even if we receive offers from buyers, whether we will be able to sell these assets at a price that would enable us to pay down our debt after accounting for related liabilities; and



- whether we will be able to generate sufficient interest among buyers for our non-core assets under current market conditions.

The success of our turnaround plan is dependent upon reducing our debt. Absent the receipt of significant proceeds from the sale of non-core assets, the raising of additional capital or a restructuring of our debt, we will not have the ability to reduce our debt or meet our significant maturing debt obligations beginning in 2005. Our senior secured term loan contains restrictions on the sale or disposition of assets, including non-core assets, and on the prepayment of the senior secured term loan and other indebtedness. Therefore, even if we are able to generate funds through the sale of non-core assets or equity, or cash flow from operations, we may not be able to prepay any of the debt in a timely manner.

**We will need significant additional capital to refinance our indebtedness as it matures. If we cannot sell sufficient assets or borrow new indebtedness sufficient to repay our indebtedness as it matures in future periods, our ability to fund our operations and service our substantial indebtedness will be adversely affected, and we will default on such maturing indebtedness as well as all other indebtedness that is cross-defaulted to such indebtedness thereby materially and adversely affecting our financial condition and results of operations.**

We will be required to obtain significant additional capital to meet debt obligations maturing in 2005 and beyond. Absent proceeds from the sale of non-core assets or significant improvements in the operating results of our non-energy

businesses, which historically have not been cash flow contributors, we will have limited ability to reduce our debt. To the extent we do not sell sufficient assets to pay down debt as it matures, we will need to borrow money. The market for indebtedness is volatile and our ability to raise capital is dependent on a number of factors including our creditworthiness, legal proceedings we are and may be involved in, the ratings of our indebtedness, the cash flow we have available to service the interest expense relating to any new borrowings, and our ability to implement our turnaround. If we are unable to refinance our indebtedness as it matures we will default on such indebtedness and all other indebtedness that is cross-defaulted to such indebtedness. Blue Dot is in default under its credit agreement. If such defaults continue or new defaults by any of our subsidiaries occur under applicable debt instruments, then such entity could seek protection under the bankruptcy law, or its creditors could institute involuntary proceedings against such entities, and we could lose our remaining investment in such entity. Any default by us on our indebtedness will have a material and adverse affect on our financial condition and results of operations.

In addition, we may not be able to generate enough cash flow to fund our operations and meet our debt service obligations. If we can not obtain additional capital to meet such obligations, we will default on such indebtedness and all other indebtedness that is cross-defaulted to such indebtedness.

**Our internal controls and procedures need to be improved.**

We have advised our Audit Committee that, in the course of preparing our financial statements for the year ended December 31, 2002 and in connection with the corresponding audit, we noted deficiencies in internal controls relating to:

- internal accounting controls relating to the EXPERT system, including the evaluation of appropriate reserves for accounts receivable and billing adjustments at Expanets;
- supervision, staffing and training of accounting personnel;
- timely evaluation and substantiation of material account balances;
- inconsistent application of and adherence to our policies and procedures by certain personnel;



- absence of a functioning internal auditing department and integrated information systems limiting our ability to adequately review subsidiary financial information; and
- the inadequacy of systems integration and data reconciliation.

These weaknesses led to the restatement of our financial statements for the first three quarters of 2002. In addition, we have experienced weaknesses in procedures and documentation relating to intercompany transactions, including lapses in documenting loans or advances to our subsidiaries which could adversely affect our ability to collect such amounts and could force us to subordinate the collection of such amounts in certain circumstances. If we are unable to substantially improve our internal controls our ability to report our financial results on a timely and accurate basis will continue to be adversely affected which could have a substantial adverse affect on our ability to operate our business.

**We are one of several defendants in a class action lawsuit brought in connection with dispositions of energy assets by The Montana Power Company, including the acquisition of our Montana utility. If we do not successfully resolve this lawsuit, or enforce our indemnification claims against The Montana Power Company, our operations and financial condition may be materially harmed.**

We are one of several defendants in a class action lawsuit entitled McGreevey, et al. v. The Montana Power Company, et al. The lawsuit, which was filed by shareholders of TouchAmerica Holdings, Inc., the successor to The Montana Power Company, in connection with the disposition of energy assets by The Montana Power Company, contends, among other things, that the shareholders of The Montana Power Company have dissenters' rights under applicable state law and are entitled to damages. We believe our substantive and procedural defenses are meritorious, but we cannot predict the outcome of any such litigation. If we are held liability for any damages in this lawsuit, our operations and financial condition may be

severely and materially harmed.

**The impact of ongoing class action litigation may be material. We are also subject to the risk of additional litigation and regulatory action in connection with the restatement of our 2002 quarterly financial statements, and the potential liability from any such litigation or regulatory action could harm our business.**

On April 1, 2003, we announced that we would restate our consolidated financial statements for the fiscal quarters ended March 31, 2002, June 30, 2002, and September 30, 2002. We have recorded significant charges in our full-year 2002 results.

We, and certain of our present and former officers and directors, are defendants in a purported class action litigation pending in the United States District Court for the Central District of South Dakota, Southern Division, entitled *Dana Ross, et al. v. Merle D. Lewis, et al.*; Case No. CIV03-4049, brought on behalf of shareholders of NorthWestern. The plaintiffs are seeking unspecified compensatory damages, rescission, and attorneys fees and costs as well as accountants and experts fees based on allegations that the defendants misrepresented NorthWestern's business operations and financial performance, overstated NorthWestern's revenue and earnings by, among other things, maintaining insufficient reserves for accounts receivables at Expanets, failing to disclose billing problems and lapses and data conversion problems, and failing to make full disclosures of problems (including the billing and data conversion issues) arising from the implementation of Expanets' EXPERT system. The lawsuit was recently filed and has not yet been served. We cannot currently predict the impact or resolution of this litigation, which could be material, and the initiation of this lawsuit may harm our business and financial condition. See "Item 3. Legal Proceedings" for more information.

As a result of the restatement of our quarterly results for the first three quarters of 2002, we could become subject to additional class action or other securities litigation. In addition, regulatory agencies,



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such as the SEC, the FERC, the MPSC, and/or the New York Stock Exchange could commence a formal investigation relating to the restatement of our quarterly results. As of the date hereof, we are not aware of any additional litigation or investigation having been commenced against us related to these matters, but we cannot predict whether or not any such litigation or regulatory investigation will be commenced or, if it is, the outcome of any such litigation or investigation. If any such investigation were to result in a regulatory proceeding or action against us, our business and financial condition could be materially adversely affected. The initiation of any additional securities litigation, together with the lawsuit described above, may also harm our business and financial condition. Until such investigation, proceeding or litigation is resolved, it may be more difficult to raise additional capital or favorably refinance or restructure our debt or other obligations. If an unfavorable result occurred in any such action, our business and financial condition could be further harmed. In addition, we are likely to incur substantial expenses in connection with any such litigation or investigation, including substantial fees for attorneys and other professional advisors. We may also be obligated to indemnify officers and directors named as defendants in such action. These expenses, to the extent not covered by available insurance, would adversely affect our cash position.

**There are a number of business challenges Expanets must address during 2003. If Expanets is not able to resolve these issues effectively, its performance will continue to be adversely affected.**

The downturn in the economy has impacted the telecommunications sector in particular. Expanets continues to see a soft market for the communications and Information Technology product industry. At the same time, Expanets plans to market a number of new solutions based on Internet protocol, or IP, technology, which is gaining more general acceptance and momentum in the market. However, Expanets can provide no specific assurance that the market will accept these solutions, which could adversely affect its performance.



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Expanets believes that its relationship with Avaya as currently structured is positive for both companies. However, a change in its relationship with Avaya or a change in Avaya's competitive position could adversely affect Expanets' performance.

Expanets must address and resolve negative customer satisfaction issues stemming from the performance deficiencies and billing inaccuracies of the EXPERT system, which has contributed significantly toward higher than anticipated erosion of Expanets' maintenance revenue and customer base. Further delays in this process could have a significant negative effect on Expanets' operations and cash flow. In addition, management has made its best estimates of billing adjustments on which our current and ongoing reserves for accounts receivable write-offs are based. If these estimates are not accurate, and our reserves are not sufficient, our results of operations or financial condition could be harmed. If the estimates are not accurate, it could have a material effect on the business, the accuracy of periodic financial reporting and negatively impact its ability to obtain third party financing or accomplish a sale of the business.

Expanets believes that it has identified many of the numerous performance and reporting deficiencies of the EXPERT system and has established alternative procedures and processes to rely on. However, there are several modules and system information flows in the EXPERTS system that have not yet been studied as a result of more pressing issues with the EXPERT system, the study of which may lead to the identification of additional material weaknesses within the EXPERT system. Expanets currently does not have the capital resources and may not have the ability to analyze these systems and processes and make necessary improvements, which could have an adverse effect on operations and negatively impact its ability to obtain third party financing or accomplish a sale of the business.

The EXPERT system continues to require additional improvement and expense to fully realize the cost savings and functionality designed into the system. Expanets' management and consultants have identified a number of system, process and procedure improvements needed to enhance internal controls and assure functional performance and reporting accuracy. Expanets currently does not have the capital resources and ability to make these improvements. Further delays in resolving performance issues of the EXPERT system and the costs of system repairs, or the delays and costs of adopting an alternative information management system, could have a material adverse effect on Expanets' operations and cash flow and could impede NorthWestern's efforts to pursue strategic alternatives for Expanets, including the sale or disposition of the business or its assets.

**If the MPSC disallows the recovery of the costs incurred in entering into default supply portfolio contracts while we are required to act as the "default supplier," we may not be able to fully recover the costs incurred in procuring default supply contracts, which could adversely affect our net income and financial condition.**

The 1997 Montana Restructuring Act provided that customers be able to choose their electricity supplier during a transition period ending on June 30, 2007. NorthWestern Energy is required to act as the "default supplier" for customers who have not chosen an alternate supplier. The Restructuring Act provided for full recovery of costs incurred in procuring a default supply portfolio of electric power and required the default supplier to propose a "cost recovery mechanism" for electrical supply procurement costs before March 30, 2002. On October 29, 2001, the former owner of NorthWestern Energy LLC filed with the MPSC its initial default supply portfolio, containing a mix of long and short-term contracts from new and existing generators. On April 25, 2002, the MPSC approved NorthWestern Energy LLC's proposed "cost recovery mechanism" in the form filed.

On June 21, 2002, the MPSC issued a final order approving contracts meeting approximately 60% of the default supply winter peak load and approximately 93% of the annual energy requirements. As a result of the order, NorthWestern Energy has implemented a procurement strategy that involves supplying the remainder of the default supply portfolio through open market purchases. Currently,



NorthWestern Energy is making short-term purchases to fill intermediate and peak electricity needs. These short-term purchases, along with the MPSC-approved base load supply, are being fully recovered through our annual electricity cost tracking process pursuant to which rates are based on estimated electricity loads and electricity costs for the upcoming tracking period and are annually reviewed and adjusted by the MPSC for any differences in the previous tracking year's estimates to actual information. This process is similar to the cost recovery process that has been successfully utilized for more than 20 years in Montana, South Dakota and other states for natural gas purchases for residential and commercial customers. The MPSC further stated that NorthWestern Energy has an ongoing responsibility to prudently administer its supply contracts and the energy procured pursuant to those contracts for the benefit of ratepayers. The MPSC could, in any particular year, disallow the recovery of a portion of the default supply costs if it makes a determination that NorthWestern Energy acted imprudently with respect to implementation of its open market purchase strategy or that the approved supply contracts were not prudently administered. A failure to recover such costs could adversely affect our net income and financial

condition.

**We are subject to extensive governmental regulations that could impose significant costs or change rates of our operations and changes in existing regulations and future deregulation may have a detrimental effect on our business and could increase competition.**

Our operations and the operations of our subsidiary entities are subject to extensive federal, state and local laws and regulations concerning taxes, service areas, tariffs, issuances of securities, employment, occupational health and safety, protection of the environment and other matters. In addition, we are required to obtain and comply with a wide variety of licenses, permits and other approvals in order to operate our facilities. In the course of complying with these requirements, we may incur significant costs. If we fail to comply with these requirements, we could be subject to civil or criminal liability and the imposition of liens or fines. In addition, existing regulations may be revised or reinterpreted, new laws and regulations may be adopted or become applicable to us or our facilities and future changes in laws and regulations may have a detrimental effect on our business.

Our utility businesses are regulated by certain state commissions. As a result, these commissions have the ability to access the regulated utility's books and records. This ability to review our books and records could result in prospective negative adjustments to our rates.

The United States electric utility and natural gas industries are currently experiencing increasing competitive pressures as a result of consumer demands, technological advances, deregulation, greater availability of natural gas-fired generation and other factors. Competition for various aspects of electric and natural gas services is being introduced throughout the country that will open these markets to new providers of some or all of traditional electric utility and natural gas services. Competition is likely to result in the further unbundling of electric utility and natural gas services as has occurred in Montana for electricity and Montana, South Dakota and Nebraska for natural gas. Separate markets may emerge for generation, transmission, distribution, meter reading, billing and other services currently provided by electric utility and natural gas providers as a bundled service. As a result, significant additional competitors could become active in the generation, transmission and distribution segments of our industry.

Proposals have been introduced in Congress to repeal the Public Utility Holding Company Act of 1935, or PUHCA. To the extent competitive pressures increase and the pricing and sale of electricity assume more characteristics of a commodity business, the economics of domestic independent power generation projects may come under increasing pressure.



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**We may not be able to fully recover transition costs, which could adversely affect our net income and financial condition.**

Montana law required the Montana Public Service Commission, or the MPSC, determine the value of net unmitigable transition costs associated with the transformation of the former The Montana Power Company utility business from a vertically integrated electric service company to a utility providing only default supply and transmission and distribution services. The MPSC was also obligated to set a competitive transition charge, or CTC, to be included in distribution rates to collect those net transition costs. The majority of these transition costs relate to out-of-market power purchase contracts, which run through 2032, that the former owner of NorthWestern Energy LLC was required to enter into with certain "qualifying facilities" as established under the Public Utility Regulatory Policies Act of 1978. The former owner of NorthWestern Energy LLC estimated the pre-tax net present value of its transition costs over the approximate 30 year period to be approximately $304.7 million in a filing with the MPSC on October 29, 2001. On January 31, 2002, the MPSC issued an Order establishing a CTC that would recover $244.7 million on a net present value basis. While the CTC is designed to adjust and compensate for future changes in sales volumes or other factors affecting actual cost recoveries, the CTC runs through the year 2029 and therefore we cannot predict with certainty the actual recovery of transition costs. Changes in the recovery of transition costs could affect our net income and financial condition.

**Further downgrades in our credit rating could negatively affect our ability to access capital.**

S&P, Moody's and Fitch rate our senior, unsecured debt at "BB+" on CreditWatch with negative implications, "Ba1" with a negative outlook and "BB+," respectively. Credit ratings are dependent on a number of quantitative and qualitative

factors. Although we are not aware of any current plans of S&P, Moody's or Fitch to further lower their respective ratings on our debt, we cannot assure you that our credit ratings will not be downgraded if we do not reduce our leverage. Although none of our debt instruments contain acceleration and repayment provisions in the event of a downgrade in our debt ratings by S&P, Moody's or Fitch, if such a downgrade were to occur, our ability to access the capital markets and utilize trade credit may be adversely affected and our borrowing costs would increase which would adversely impact our results and condition. We may also be required to provide credit support for certain major purchases (*e.g.*, electricity supply contracts, natural gas supply contracts, etc.) In addition, we would likely be required to pay a higher interest rate in future financings and our potential pool of investors and funding sources could decrease.

**We are subject to risks associated with a changing economic environment.**

In general, the financial markets have been weak and the availability and cost of capital for our business and that of our competitors has been adversely affected. Events such as the bankruptcy of several large energy and telecommunications companies have specifically contributed to this weak environment. Such economic environment, if sustained, could constrain the capital available to our industry and would adversely affect our access to funding for our operations, including the funding necessary to refinance or restructure our substantial indebtedness. In addition, the disruption on the capital markets due, in large part, to the capital structure of energy companies, could adversely impact our ability to realize cash from the sale of the Montana First Megawatts project. If our ability to access capital becomes significantly constrained, our financial condition and future results of operations could be significantly adversely affected.

**Our revenues and results of operations are subject to risks that are beyond our control, including but not limited to future terrorist attacks or related acts of war.**

The cost of repairing damage to our facilities due to storms, natural disasters, wars, terrorist acts and other catastrophic events, in excess of reserves established for such repairs, may adversely impact



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our results of operations, financial condition and cash flows. Generation and transmission facilities, in general, have been identified as potential terrorist targets. The occurrence or risk of occurrence of future terrorist activity may impact our results of operations, financial condition and cash flows in unpredictable ways. These actions could also result in adverse changes in the insurance markets and disruptions of power and fuel markets. The availability of insurance covering risks we and our competitors typically insure against may decrease. In addition, the insurance we are able to obtain may have higher deductibles, higher premiums and more restrictive policy terms. In addition, our electric transmission and distribution, electric generation, natural gas distribution and pipeline and gathering facilities could be directly or indirectly harmed by future terrorist activity.

The occurrence or risk of occurrence of future terrorist attacks or related acts of war could also adversely affect the United States economy. A lower level of economic activity could result in a decline in energy consumption, which could adversely affect our revenues and margins and limit our future growth prospects. Also, these risks could cause instability in the financial markets and adversely affect our ability to access capital.

**Our operating results may fluctuate on a seasonal and quarterly basis.**

Our electric and gas utility business and, to a lesser extent, Blue Dot's HVAC business are seasonal businesses and weather patterns can have a material impact on their operating performance. Because natural gas is heavily used for residential and commercial heating, the demand for this product depends heavily upon weather patterns throughout our market areas and a significant amount of natural gas revenues are recognized in the first and fourth quarters related to the heating season. Demand for electricity is often greater in the summer and winter months associated with cooling and heating. Similarly, Blue Dot's business is subject to seasonal variations in certain areas of its service lines, with demand for residential HVAC services generally higher in the second and third quarters. Accordingly, our operations have historically generated less revenues and income when weather conditions are milder in the winter and cooler in the summer. In the event that we experience that unusually mild winters or summers in the future, our results of operations and financial condition could be adversely affected.

**Our announcement that we are considering strategic alternatives for, and do not intend to make additional significant**

**investments in, Blue Dot or Expanets, together with other liquidity issues confronting Blue Dot and Expanets, may materially and adversely affect the operations and value of those entities.**

We are considering strategic alternatives for Blue Dot and Expanets, including a sale or disposition of such businesses or their assets, and we do not intend to make additional significant investments in Blue Dot or Expanets while we examine strategic alternatives for these businesses. In connection with approval of our $390 million senior secured term loan, the Montana Public Service Commission has restricted our ability to make additional investments or commitments to our non-regulated businesses to $10 million in the aggregate unless we obtain prior approval. These initiatives, together with other liquidity issues confronting Blue Dot and Expanets, present a substantial risk of serious disruption to the businesses of Blue Dot and Expanets and may materially and adversely affect the value of those entities.

Each of Blue Dot and Expanets has limited cash to meet its obligations and will have to locate its own independent source of funds should it require additional financing. If either company is unable to obtain necessary financing or to maintain adequate bonding capacity, it may default on one or more of its obligations, which could result in a serious disruption in its business and materially and adversely impair its value. Neither of those companies has sufficient working capital to satisfy its debt obligations as they mature, or in the event of an acceleration of all or a significant portion of its outstanding indebtedness. In addition, Blue Dot is currently in default under its existing credit facility and certain



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other material payment obligations to its minority stockholders and is prohibited as a result of the defaults under its credit facility from paying certain other outstanding obligations. NorthWestern Growth Corporation may be required to purchase or cause the purchase of certain shares of Blue Dot stock in an amount sufficient to permit Blue Dot to effect its exchange obligations under its exchange agreements with respect to its Series A Preferred Stock and honor its payment obligations under certain call and put option agreements and certain related earnout obligations with respect to its Class C Common Stock under certain circumstances; however, NorthWestern subsequently indicated that no additional funds will be provided to Blue Dot while NorthWestern pursues strategic alternatives for Blue Dot, including the sale or disposition of the business or its assets. Blue Dot's credit facility prohibits the Blue Dot from performing its obligations under its exchange agreements or any call and put agreements unless the funds or stock used to satisfy such obligations are provided to Blue Dot by NorthWestern. The existing defaults under the credit facility also prevent Blue Dot from making payments of principal and interest on certain subordinated debt and may result in defaults under other indebtedness that is cross defaulted to the credit facility. As a result of these events, Blue Dot defaulted on up to $4.1 million of the obligations under its exchange and call and put option agreements on March 31, 2003. Approximately $4.4 million is required to be paid under call and put option agreements on June 30 2003, approximately $.5 million may be required to be paid under exchange agreements on September 30, 2003. In addition, approximately $0.5 million in principal payments plus related interest on subordinated indebtedness is scheduled to become due in 2003. Blue Dot is attempting to negotiate extensions, repayment terms or other arrangements to satisfy these obligations with certain of the involved parties. Blue Dot's failure to pay these obligations has resulted in additional defaults under its credit facility, which is non-recourse to us.

These defaults and the failure of Blue Dot to pay these obligations could result in a serious disruption in Blue Dot's business and materially and adversely impact Blue Dot's value. The impacted key managers and other personnel from the impacted units might leave Blue Dot and certain stockholders may institute securities or other litigation against Blue Dot and NorthWestern Growth Corporation seeking immediate payment of these or similar obligations or other damages. In addition, other key managers from other operating units, including managers who are under similar arrangements, may leave Blue Dot or become disengaged and cause further significant disruption of the organization.

Substantial uncertainty and concern may also develop on the part of the employees, suppliers and customers of Blue Dot and Expanets. Existing employees, including key managers, and customers may elect to leave those businesses because of these issues or in anticipation of a sale of the business or its assets and it may be difficult to attract replacements. In some cases we may not have non-competition agreements or only limited ability to enforce such agreements with respect to such departing employees. Certain key employees of Blue Dot may, in particular, be dissatisfied because of the deferrals of certain incentive compensation payments. Suppliers may elect to eliminate, restrict, reduce or impose more burdensome terms on credit, which would increase Blue Dot's and Expanets' cost of goods and create additional liquidity issues.

**Changes in commodity prices and availability of supply may increase our cost of producing and distributing electricity and distributing natural gas or decrease the amount we receive from selling electricity and natural gas, adversely affecting our financial performance and condition.**

To the extent not covered by long-term fixed price purchase contracts, we are exposed to changes in the price and availability of coal because most of our generating capacity is coal-fired. Changes in the cost of coal and changes in the relationship between those costs and the market prices of power may affect our financial results. In addition, natural gas and electricity are commodities; the market price of which can be subject to volatile changes in response to changes in the world crude oil market, refinery operations, power plant outages, weather conditions, supply or other market conditions.



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Because state regulatory authorities set the rates at which we sell electricity and natural gas, and may modify the costs that we may pass through the fuel and gas cost adjustments, we may not be able to immediately pass on to our retail customers rapid increases in the wholesale cost of coal and natural gas, which could reduce our profitability.

We do not own any natural gas reserves and do not own electric generation assets to service our Montana operations. We own interests in generation assets that substantially cover our electric supply requirements in South Dakota. As a result, we are required to procure our entire natural gas supply and all of our Montana electricity supply pursuant to contracts with third party suppliers. In light of this reliance on third party suppliers, we are exposed to certain risks in the event a third party supplier is unable to satisfy its contractual obligation.

**We do not intend to pay dividends on our common stock, and our ability to pay dividends on our common stock is limited.**

Consistent with our turnaround plan to increase liquidity and reduce debt, the Board of Directors decided to terminate the historical practice of paying an annual cash dividend. We do not anticipate paying any cash dividends for the foreseeable future.

In addition, we are currently prohibited from paying dividends on our common stock under Delaware law. The Delaware General Corporation Law, or the DGCL, allows the Company to pay dividends only out of its surplus (as defined and computed in accordance with the provisions of the DGCL) or if the Company has no such surplus, out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year. We will be unable to pay dividends on or redeem any of our capital stock until such time as we again have available surplus or net profits.

Our senior credit facility also prohibits the payment of dividends during any period of default under the agreement. To the extent that payment of a cash dividend on our common stock becomes permissible under Delaware law, we would only be able to pay a cash dividend on our common stock to the extent that all required distributions on our mandatorily redeemable preferred securities of trusts had been made.

See "Market for Registrant's Common Equity and Related Stockholder Matters" included in Item 5 hereof for additional information about our ability to pay dividends on our common stock.

**Our utility business is subject to extensive environmental regulations and potential environmental liabilities, which could result in significant costs and liabilities.**

Our utility business is subject to extensive regulations imposed by federal, state and local government authorities in the ordinary course of day-to-day operations with regard to the environment, including environmental regulations relating to air and water quality, solid waste disposal and other environmental considerations. Many of these environmental laws and regulations create permit and license requirements and provide for substantial civil and criminal fines which, if imposed, could result in material costs or liabilities. We regularly monitor our operations to prevent adverse environmental impacts and to assess potential environmental liabilities. We may be required to make significant expenditures in connection with the investigation and remediation of alleged or actual spills and the repair and upgrade of our facilities in order to meet future requirements under environmental laws.

Environmental laws and regulations require NorthWestern to incur certain costs, which could be substantial, to operate existing facilities, construct and operate new facilities, and mitigate or remove the effect of past operations on the environment. Governmental regulations establishing environmental protection standards are continually evolving, and, therefore, the character, scope, cost and availability of the measures NorthWestern may be required to take to ensure compliance with evolving laws or regulations cannot be predicted. However, NorthWestern believes that an appropriate